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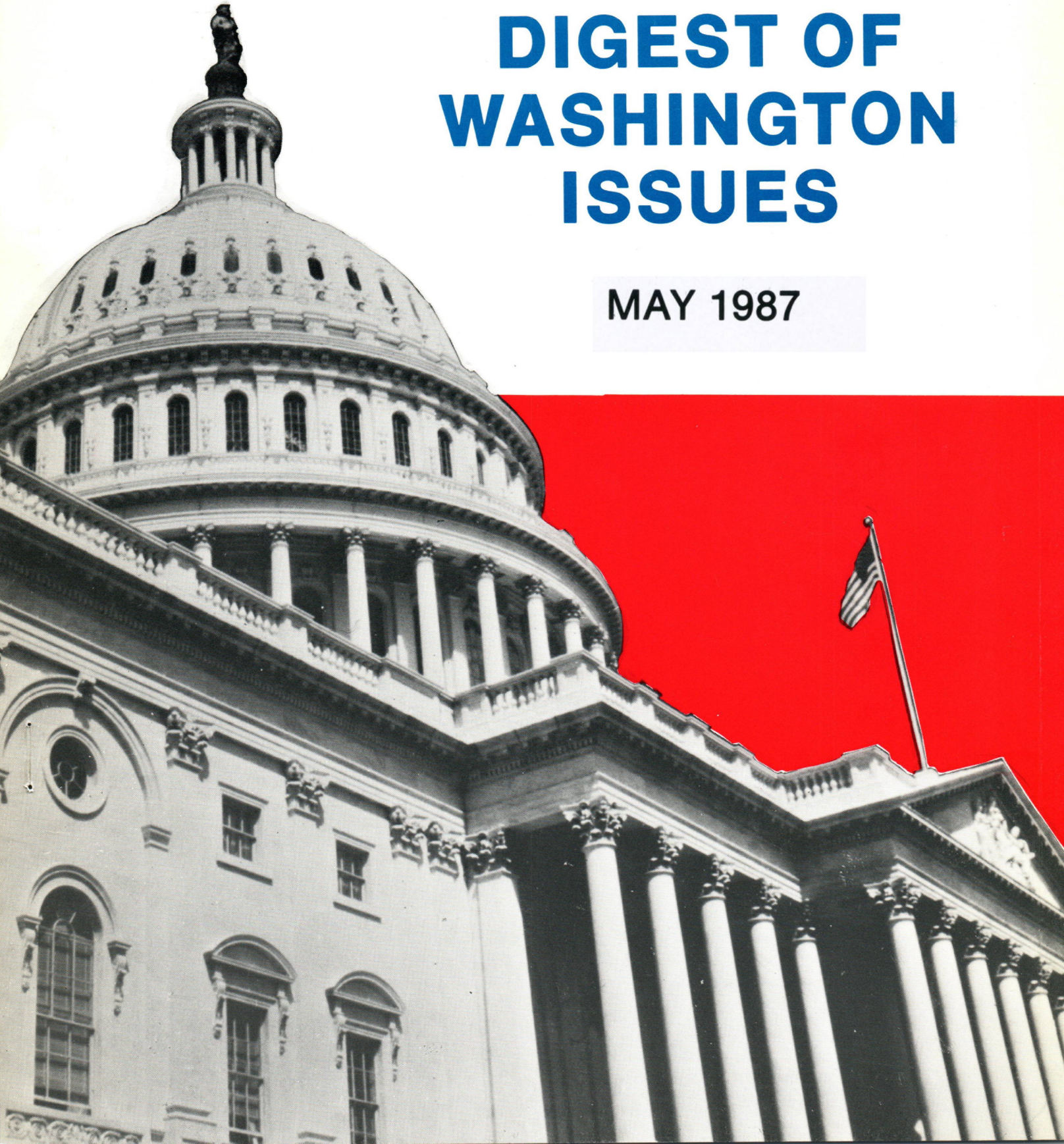
American Institute of Certified Public Accountants. Political & Legislative Affairs Division

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

AICPA 100
A CENTURY OF PROGRESS
IN ACCOUNTING
1887-1987

DIGEST OF WASHINGTON ISSUES

MAY 1987



AICPA

MAJOR CONGRESSIONAL ISSUES

MODIFICATION OF YEAR-END CONFORMITY PROVISION OF TRA 86 PERMITTING RETENTION OF FISCAL YEARS

ISSUE

Should the provision contained in the Tax Reform Act of 1986 (TRA 86) that requires most partnerships, S corporations and personal service corporations to adopt a calendar year-end for tax purposes be modified?

AICPA POSITION

The AICPA believes that the 1986 Act provision, requiring most partnerships, S corporations and personal service corporations to conform their tax years to the tax years of their owners should be substantially modified.

Our arguments for modification are as follows:

1. The provision will make it difficult, and in many cases impossible, for taxpayers and return preparers to complete partnership, S and personal service corporation returns in sufficient time to allow partners and shareholders to file individual income tax returns by the original due date.

2. All affected entities would be required to incur the costs of closing their books and filing two sets of tax returns (both federal and state) for each of the two periods ending in calendar 1987.

3. It is in the public interest to encourage staggered tax return filing dates through the use of fiscal years. We believe that the IRS, taxpayers, and tax practitioners can better meet tax filing requirements if the demands are spread throughout the year.

4. Because this provision applies to existing, as well as newly formed entities, businesses which have used a fiscal year for many years will now have to amend contracts, compensation arrangements, and retirement and employee benefit plans.

5. The 1986 Act fails to recognize that there are many legitimate business reasons to select a fiscal year rather than a calendar year.

6. The 1986 Act provision will increase the annual return processing costs for the IRS.

BACKGROUND

In the two year effort to draft tax legislation during the 99th Congress, at all times it was understood that any reforms or changes must adhere to a "revenue neutral" standard. This meant

any change that would reduce tax revenue to the Treasury would have to be balanced with a change that would add tax revenue.

In the final hours of Senate deliberation and debate on tax reform, Senator George Mitchell (D-ME) proposed the stringent year-end conformity rule as a trade-off to allow certain tax benefits for developers of low-income housing. This proposal was advanced only as a means of providing the revenue to fund the low-cost housing rather than for any sound tax policy reason. After brief debate and with little guidance, the Mitchell Amendment was adopted by the Senate.

During the conference on TRA 86, members of Congress were facing many political pressures. They needed to produce "revenue neutral" legislation, and they were being asked by literally hundreds of special interest groups to add favorable treatment or to eliminate troublesome provisions. The compromise tax bill which became law did not address the accounting profession's concerns regarding the year-end conformity provision.

The AICPA Board of Directors, at its December meeting, approved a major initiative to seek legislation in the 100th Congress to modify the provision. This issue will have the highest priority of all tax legislative issues on the AICPA agenda.

RECENT DEVELOPMENTS

When the Congress returned in January, representatives of the AICPA Tax Division began a series of meetings with Senate Finance, House Ways & Means, and the Joint Committee on Taxation members and staff in an effort to draft corrective legislation which would permit continuation of fiscal years. During our meetings, members of Congress and their staffs have been unanimous and adamant in their position that any proposal for change be "revenue neutral" and that the revenue raised must address the policy issue of tax deferral.

Since January, we have considered many proposals. Some have been set aside because they are not revenue neutral. Some have been rejected as being overly complex. Some which sounded attractive and simple as concepts became unworkable and complex when we developed the specifics. Members of the Tax Division and senior AICPA staff have devoted hundreds of hours trying to work out a viable solution that is revenue neutral and not so complex as to be politically undesirable.

There is great interest by members of Congress in working with us to find a viable solution to the serious problems which will be created by the taxable year conformity requirement. One indication of the level of interest is the number of legislative proposals which have been introduced in the House of Representatives and in the Senate regarding this matter. Of the six bills pending in the House, none are revenue neutral. Five of the House bills call simply for repeal. The sixth House bill and the one Senate bill call for a one-year delay in the implementation of the

taxable year conformity provision, but they do not attempt to identify a long-term resolution.

We are hopeful that a viable solution can be developed shortly, and we believe a direct solution to the problem, if at all possible, is preferable to a postponement.

POSITION OF OTHERS

None identified at this time.

JURISDICTION

SENATE - Committee on Finance

HOUSE - Committee on Ways and Means

RACKETEER INFLUENCED AND CORRUPT ORGANIZATIONS ACT (RICO)

ISSUE

Should the civil provisions of the RICO statute be amended?

AICPA POSITION

The AICPA believes that H.R. 5445, a compromise proposal negotiated at the end of the 99th Congress and passed overwhelmingly by the House and narrowly rejected by the Senate, is the best that can be achieved in terms of RICO reform in the new Congress. However, we are currently working with all interested parties to see if there are alternatives or amendments that can be made to H.R. 5445 that would make it acceptable to all concerned groups. The general consensus is that if H.R. 5445 is going to be changed at all, it cannot be changed very much and remain politically viable.

BACKGROUND

RICO is one part of the 1970 Organized Crime Control Act. Congress authorized private persons victimized by a "pattern" of "racketeering activity" to sue for treble damages and attorneys' fees. In describing the kinds of "racketeering activity" that could give rise to such lawsuits, however, Congress included not only murder, arson, extortion, kidnapping, and drug trafficking, but also mail fraud, wire fraud, and fraud in the sale of securities.

For the first 10 years after passage, few plaintiffs brought RICO suits. Since 1980, however, its use has accelerated rapidly. The mail and wire frauds and fraud in the sale of securities "predicates" to liability have become the principal bases for private RICO cases. Instead of being used as a weapon against organized crime, private civil RICO has become a regular feature of ordinary commercial litigation. RICO cases growing out of securities offerings, corporate failures, and investment disappointments have become almost routine. Many of these cases have included accountants as co-defendants who are charged with participating in an alleged "pattern of racketeering activity."

Early in the 99th Congress, the AICPA decided to take the lead in convincing Congress to cure these abuses. The AICPA also urged the Supreme Court to interpret the existing law narrowly so as to confine it to the kinds of criminal enterprises the Congress had in mind. Our position was that before a civil RICO claim could be brought, the person or firm being sued would first have to be convicted of a crime. By a 5-4 vote, however, the Court disagreed and ruled in the Sedima case in July 1985

that it was up to Congress to fix the defects in the statute that all Justices agreed had caused RICO to be used in ways Congress never intended.

The AICPA thereafter spearheaded a concerted legislative effort to amend civil RICO. It brought together a coalition representing the securities industry, the life insurance and property and casualty insurance industries, banks and major manufacturers and their trade associations. In addition, the coalition worked together with representatives of major labor unions, led by the AFL-CIO, that also supported major reforms of civil RICO to prevent its growing abuse.

The principal sponsor in the House of the AICPA's preferred solution to the RICO problem was Rep. Frederick C. Boucher (D-VA). In July of 1985, he introduced a bill that would have limited civil RICO suits to cases in which the defendant had been convicted of a criminal act.

While the Boucher bill garnered widespread support in Congress, consumer groups strongly opposed the legislation and were able to enlist key Chairmen to block the bill's progress. The business-labor coalition, led by the AICPA, met with the consumer groups and key legislative personnel and negotiated a compromise proposal that would have reduced RICO's treble-damage provision to single damages in certain cases, including whenever there already existed a federal or state securities remedy. The AICPA and other groups supported this compromise because it was a substantial improvement over current law.* The compromise bill passed the House by a vote of 371 to 28 on October 7, 1986.

In the Senate, however, the Justice Department urged Senators not to accede to a compromise, even if it meant deferring the prospects for reform until the new Congress convened in 1987. The Justice Department believed that the Republicans would retain control of the Senate and a "better bill" could be obtained in 1987. In addition, some elements of the insurance and banking communities urged Senators to oppose the compromise because they too believed a Republican Senate would pass a better bill in the 100th Congress. The Senate voted down the bill by a 47-44 vote.

RECENT DEVELOPMENTS

In the wake of the insider trading scandals that have rocked Wall Street, some opposition has arisen in Congress to an important provision in our proposal for a compromise bill. The provision we favor would eliminate multiple damages in a RICO suit if the suit is based on a transaction otherwise subject to federal or state securities laws. This is the situation for most RICO cases in which accountants and accounting firms are defendants.

The securities exemption provision is vitally important to the accounting profession. Since there is little that would help us in the compromise RICO proposal without the securities exemption, the AICPA has notified all interested parties that we will oppose any compromise legislation that does not include the securities exemption provision. We are fighting hard for a reasonable and fair securities exemption.

POSITION OF OTHERS

There is widespread support for amending civil RICO. There are some elements of the business community that do not presently support the compromise bill, but there are good reasons to believe that with some moderate changes in the House-passed bill, they will support the legislation. The Justice Department is also re-evaluating its position.

JURISDICTION

SENATE - Committee on the Judiciary

HOUSE - Committee on the Judiciary

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*For additional information and an explanation of why the compromise bill is better than current law, contact Theodore C. Barreaux, Vice President - Washington.

CONGRESSIONAL OVERSIGHT HEARINGS ON THE ACCOUNTING PROFESSION (DINGELL HEARINGS)

ISSUE

Are independent auditors fulfilling their responsibilities relative to audits of publicly owned corporations?

AICPA POSITION

The profession is acting responsibly to meet public expectations and to enhance the effectiveness of independent audits. This includes:

- Strengthening audit quality by expanding the scope and requirements for peer review conducted under the supervision of the Institute's SEC Practice Section and the Public Oversight Board.
- Extensive projects by the Auditing Standards Board on internal control, fraud and illegal acts, auditors' communications and other "expectation gap issues."
- The creation of the National Commission on Fraudulent Financial Reporting, chaired by former SEC Commissioner James C. Treadway.
- Recommendations to the SEC for expanded disclosure of the reasons for resigning from an audit engagement, particularly when there are questions about management's integrity.

BACKGROUND

In February 1985, under the chairmanship of Congressman John Dingell (D-MI), the Subcommittee on Oversight and Investigations of the House Energy and Commerce Committee began hearings on the accounting profession. The hearings focused on the effectiveness of independent accountants who audit publicly owned corporations and the performance of the SEC in meeting its responsibilities. Among others, hearings were held on the failures of ESM Government Securities, Inc. and Beverly Hills Savings and Loan. In all, 17 day-long sessions were held between 1985 and 1986, and over 100 witnesses testified. There were no hearings held on this issue in the U.S. Senate during 1985-1986.

The last two days of hearings focused on a bill, the "Financial Fraud Detection and Disclosure Act of 1986," that was introduced by Congressman Ron Wyden (D-OR). (For details, see next issue.)

RECENT DEVELOPMENTS

The staff of the Oversight and Investigations Subcommittee has informed us that more hearings will be conducted during the 100th Congress. The next hearing will most likely focus on the recommendations of the National Commission on Fraudulent Financial Reporting (Treadway Commission), which were exposed in late April. Members of the Treadway Commission are expected to testify in June, 1987.

POSITION OF OTHERS

The SEC, the GAO, and many business organizations support the profession's self-regulatory efforts and oppose the Wyden Bill.

JURISDICTION

SENATE - Committee on Banking, Housing, and Urban Affairs

Securities Subcommittee

HOUSE - Committee on Energy and Commerce

Oversight and Investigations Subcommittee

Telecommunications and Finance Subcommittee

THE FINANCIAL FRAUD DETECTION AND DISCLOSURE ACT (THE WYDEN BILL)

ISSUE

Should Congress enact the "Financial Fraud Detection and Disclosure Act?"

AICPA POSITION

The AICPA opposes such legislation for the following reasons:

- The responsibility for dealing with fraud and illegal acts, including the responsibility to report such matters to the appropriate regulators, currently rests with the company's board of directors and audit committee. The Wyden bill would inappropriately shift that responsibility to the independent auditor.

- The bill would substitute a system of governmental surveillance and supervision of corporate activities for that which has traditionally been exercised by corporate directors elected by the entities' shareholders.

- The bill would result in the forced enlistment of the accounting profession in the work of every federal, state, and local regulatory body and enforcement agency. This bill would convert the "public's watchdog" into the "government's bloodhound."

- The bill would actually diminish -- not increase -- the effectiveness of independent audits. A healthy professional skepticism is essential to the conduct of an audit. However, the Wyden bill would force the auditor into a direct adversarial relationship with the company being examined, inhibiting frank communication necessary for an effective audit.

- The bill, if enacted, would add greatly to the costs of audits without apparent corresponding benefit.

BACKGROUND

During the 99th Congress, Congressman Ron Wyden (D-OR) introduced H.R. 4886, "Financial Fraud Detection and Disclosure Act of 1986." The bill would have required, among other provisions, auditors of public companies to:

- Detect, without regard to materiality, any actual or suspected illegal or irregular activity by any director, officer, employee, agent, or other person associated with the audited entity.

- o Report publicly and to applicable federal, state, or local regulatory or enforcement agencies all instances of actual or suspected illegal or irregular activities.

- o Evaluate and report publicly on the audited entity's system of internal administrative and accounting controls.

A revised version of the Wyden bill was later introduced reflecting two major changes. First, it included the notion of materiality, although the bill's discussion of materiality was much broader than financial statement materiality. Second, the primary burden for reporting irregularities and illegal acts to enforcement and regulatory agencies was placed on the client. However, the auditor would still have independent reporting responsibilities that are inappropriate to the auditor's function. A further revision of the bill is being considered which is expected to be only marginally different from the first revision.

RECENT DEVELOPMENTS

The 99th Congress adjourned without taking any action on the proposed legislation. The legislation has not been reintroduced in the current Congress.

POSITION OF OTHERS

Currently, there is little, if any, support for such legislation from the SEC, the GAO, and the business community.

JURISDICTION

SENATE - Committee on Banking, Housing and Urban Affairs

Securities Subcommittee

HOUSE - Committee on Energy and Commerce

Oversight and Investigations Subcommittee

Telecommunications and Finance Subcommittee

VARIOUS LEGISLATIVE PROPOSALS IN CONFLICT WITH GAAP

ISSUE

Should the Congress legislate accounting standards?

AICPA POSITION

The AICPA believes that accounting standards used in the preparation of financial statements should be set in the private sector and not by legislation. Our concern is that regulatory accounting principles that are inconsistent with generally accepted accounting principles could erode public confidence in published financial reports. Such a loss of confidence may cause severe repercussions in our capital markets.

BACKGROUND

In the private sector, the Financial Accounting Standards Board (FASB) establishes and improves standards for financial accounting and reporting. We acknowledge that Congress and regulatory agencies have the authority to set accounting standards for regulatory reporting purposes; however, we are concerned that differences between regulatory accounting principles and generally accepted accounting principles (GAAP) could be confusing to the users of financial statements. Futhermore, past attempts to improve the financial conditions of troubled institutions by allowing the deferral and amortization of loan losses under regulatory accounting principles have failed to accomplish the desired objective, and may have, in fact, increased the potential loss.

RECENT DEVELOPMENTS

In the 99th Congress, legislation was introduced in the Senate and the House of Representatives allowing Farm Credit System banks to amortize, over a 20 year period, losses resulting from poorly performing loans. The AICPA and the General Accounting Office (GAO) conveyed their concerns regarding the proposal noting that the legislation would have the effect of hiding the serious financial problems the System would experience in the future. The measure was signed by President Reagan on October 21, 1986, becoming Public Law 99-509.

In the 100th Congress, Rep. Steve Bartlett (R-TX) introduced the "Thrift Forbearance and Supervisory Reform Act." A provision of this legislation would establish new accounting standards for thrifts by allowing savings institutions to amortize, over a five to ten year period, losses resulting from poorly performing loans. Following introduction of the bill, the AICPA provided comments to the House Banking Committee indicating our concern

about the provision. Our letter noted that the treatment proposed by the Bartlett legislation was inconsistent with GAAP which requires such losses to be written off immediately. When the House Banking Committee approved legislation to recapitalize the Federal Savings and Loan Insurance Corporation (FSLIC), it included certain provisions of the Bartlett proposal, although the Committee deleted the thrift amortization language.

In the Senate, the "Competitive Equality Banking Act of 1987," includes an amendment allowing insured banks whose primary business is providing agriculture loans to amortize, over a period of ten years, losses resulting from poorly performing loans. The AICPA expressed its concern to Senate Banking Committee Chairman William Proxmire (D-WI). Since the language establishing new accounting standards is not included in the House measure, a compromise will be worked out in a House and Senate Conference.

Another Senate bill, the "International Lending Institution Safety Act of 1987," also proposes accounting standards inconsistent with GAAP. The measure requires the establishment of a special reserve of not less than 10 percent of the difference between the book value of the institution's aggregate transfer risk exposure to foreign countries and the actual value of the exposure. The reserve would be increased annually by 10 percent of the difference between the book value and the actual value of the exposure. Deferral of loan losses for Loans to Developing Countries (LDC loans) would jeopardize the credibility of bank financial statements. The success of the U.S. financial markets is largely based on having credible financial information.

POSITION OF OTHERS

The FASB and GAO generally oppose legislation establishing accounting standards inconsistent with generally accepted accounting principles.

JURISDICTION*

SENATE - Committee on Banking, Housing, and Urban Affairs

HOUSE - Committee on Banking, Finance, and Urban Affairs

* Other committees may also have jurisdiction. For example, legislation regarding the Farm Credit System was referred to the Committees on Agriculture. If legislation was introduced regarding oil & gas accounting, it would be referred to the Committees on Energy.

CONGRESSIONAL HEARINGS ON THE QUALITY OF AUDITS OF FEDERAL FINANCIAL ASSISTANCE (BROOKS HEARINGS)

ISSUE

What can be done to improve the quality of audits of federal financial assistance performed by CPAs?

AICPA POSITION

The AICPA has recognized that this is an urgent problem and, among other steps, has formed a Task Force to develop ways to improve the quality of audits of governmental units. The Task Force's final report contains 25 recommendations for improving the quality of such audits. The report has been widely distributed.

Other actions that have been taken by the Institute include publication of a revised audit guide on audits of state and local governmental units, presentation of training programs throughout the country on the Single Audit Act, and expansion of the peer review program of the Division for CPA Firms to include examination of governmental units.

BACKGROUND

The Legislation and National Security Subcommittee of the House Committee on Government Operations, under the chairmanship of Congressman Jack Brooks (D-TX), is investigating the quality of audits of federal grants to state and local governments and to nonprofit organizations. Hearings began in November 1985. A March 1986 GAO study found that 34 percent of the governmental audits performed by CPAs did not satisfactorily comply with applicable standards. The two biggest problems identified were insufficient audit work in testing compliance with governmental laws and regulations and in evaluating internal accounting controls over federal expenditures.

In October 1986, the Brooks Committee released a report to Congress, "Substandard CPA Audits of Federal Financial Assistance Funds: The Public Accounting Profession is Failing the Taxpayers," concluding that dramatic improvements must be made in the quality of CPA audits of federal financial assistance funds.

The basic recommendations in the report are:

- Action should be taken to assure that CPAs are properly trained in governmental auditing.
- The State Boards of Accountancy and the AICPA should impose

strict sanctions on CPAs who perform substandard audits.

- The Inspectors General should strengthen their quality review systems.

- The GAO should revise its Standards for Audit of Governmental Organizations, Programs, Activities, and Functions (the "Yellow Book") to include a specified amount of CPE in governmental auditing, as well as a requirement that CPA firms auditing federal financial assistance funds undergo periodic peer reviews.

Congressman Brooks has concluded that there is no doubt that there are serious problems in the quality of governmental audits and "if the accountants can't solve them, somebody will." He also indicated that he will continue hearings to monitor improvements.

RECENT DEVELOPMENTS

Congressman Brooks has requested that the GAO conduct a comprehensive study of the procedures used by state and local governmental units in contracting for audit services. The results of that study are expected to be issued in early 1987.

The AICPA Board of Directors accepted, at its February 1986 meeting, the Report of the Task Force on the Quality of Audits of Governmental Units and approved its distribution.

A special committee has been established to monitor implementation of the recommendations.

POSITION OF OTHERS

The GAO, the federal Inspectors General, the State Auditors, the State Boards of Accountancy, State Societies and other organizations are all working together to develop and implement ways to improve the quality of CPA audits of federal financial assistance funds.

JURISDICTION

SENATE - Committee on Governmental Affairs

HOUSE - Committee on Government Operations

Legislation and National Security Subcommittee

THE FEDERAL CONTRACTORS' SELF-GOVERNANCE ACT (PROXMIRE BILL)

ISSUE

Should the "Federal Contractors' Self-Governance Act" be enacted?

AICPA POSITION

The AICPA has not taken a position on the proposed bill, but believes that any such bill should be drafted so that the legislative language is consistent with professional auditing literature.

BACKGROUND

In August 1986, Senator William Proxmire (D-WI) introduced S. 2738, the "Federal Contractors' Self-Governance Act." Senator Proxmire is concerned about reports that some government contractors are overcharging on government contracts.

In his opening remarks, Senator Proxmire said that this legislation is ... "part of a package of bills I am preparing to improve defense contracting and financial accountability."

Following are the key provisions of the bill:

- It applies to both prime and subcontractors of major long-term federal government contracts, defined as a contract covering more than one year and at least $10,000,000.

- The contractor must establish and maintain a system of internal accounting and administrative controls (also defined) that provides reasonable assurance that estimate, cost, price, billing, and performance measurement data provided to the federal government are reasonably accurate and in conformance with the applicable law and regulation.

- The issuer shall report annually whether such a system has been maintained, any material weaknesses, and plans and schedules for correcting such weaknesses.

- Independent public accountants must annually determine and report whether the issuer has maintained such a system. To do that, the auditor must test a representative number of transactions relating to each of the major long-term federal government contracts and perform such other procedures as may be necessary under the circumstances.

- Internal administrative controls include: estimating procedures, statistical analysis, time and motion studies, performance measurement reports, employee training programs, and quality control.

RECENT DEVELOPMENTS

The Congress adjourned without taking action on the bill. The legislation has not been reintroduced in the current Congress.

POSITION OF OTHERS

None identified at this time.

JURISDICTION

SENATE - Committee on Banking, Housing, and Urban Affairs

Securities Subcommittee

HOUSE - Committee on Energy and Commerce

Telecommunications and Finance Subcommittee